A MODIFIED CENTRAL BANK OF ISSUE

With many sincere thanks
and kindest regards

A SUGGESTION OF A BILL

for

BY

Paul M Warburg

PAUL M. WARBURG

NEW YORK, 1908

Prof. Edwin R. A. Seligman

Professor Edwin Robert Anderson Seligman (1861-1939).

PREFACE

I have been repeatedly asked to show in detail, how I would construct the "modified Central Bank," the creation of which I have championed on various occasions.

It is in compliance with this request that I herewith submit the following draft of a bill.

In doing so I do not pretend to present a perfect legal document, nor do I claim that it could not be modified to advantage in many details. It is of minor importance for this preliminary draft whether the country shall be divided into twenty or thirty "bank association districts", or whether there shall be twenty or forty members of the board of managers. These eminently practical and political questions will have to be carefully worked out upon full consideration of all sides of the question. This draft of a bill merely purports to show the lines that such an act, according to my ideas, would have to follow.

There are, however, certain facts and fundamental principles which, I am convinced, must be clearly recognized and rigidly observed in dealing with this question. They are as follows:

FIRST--- The United States must finally develop some kind of a central bank system, giving the country an elastic currency based on modern commercial bills payable in gold: a system similar in principle, if not exactly alike in form, to those of the important European Central Banks.

SECOND--- While this must be the final aim, our political, legal and economic conditions preclude the possibility of creating at present an institution with powers and efficiency equal to those of the European Government Banks.[$] In previous publications I have tried to point out the far-reaching preparatory steps that will have to be taken before the final goal can be reached.[*]

THIRD--- We shall, therefore, have to be satisfied to advance slowly, fully realizing that what we create now can only be an initial step. BUT IT

$ ---[because we can't allow a government to be its own fiscal agent; a government which tells the bankers what not to do; a government that sets limits to the activities of bankers. Internationalist bankers decided that the U.S. must have a grand-central discount bank, and that was that; no ifs, buts, or questions. 80 million citizens didn't ask or clamour for a “bankers' bank” farmers didn't ask for it, industrial producers didn't ask for it; only bankers in Frankfurt and New York demanded it. The question wasn't even allowed to be asked, much less examined, whether the U.S. needs a bankers' bank, whether the U.S. could exist and prosper without it. The circle of friends in Frankfurt decided the U.S. must have one; end of discussion.]

* "American and European Banking Methods and Bank Legislation Compared," in the volume entitled, *The Currency Problem and the Present Financial Situation*. New York: The Columbia University Press, 1908; and also separately.

MUST BE A STEP IN THE RIGHT DIRECTION, A MEASURE WHICH HAS CLEARLY IN VIEW THE FINAL AIM AND WHICH DOES NOT NEGLECT ANY OF THE FUNDAMENTAL PRINCIPLES ON WHICH MODERN CENTRAL BANK SYSTEMS HAVE BEEN ERECTED IN OTHER COUNTRIES, and which have already stood the test of storm and stress.[$$]

FOURTH--- From this point of view no measure can be acceptable:

A--- Which bases currency on long time obligations, like the Aldrich Bill. (Short obligations not exceeding three months and payable in gold form the only sound basis for an elastic currency. Only by having daily maturing paper and by collecting or renewing it according to the requirements of the moment, can the Central Bank control the situation and meet its own gold obligations.)

B--- No measure can be acceptable which would tend still further to decentralize the power of issuing notes, and which would vest this power in banks doing a general commercial business. The issuing of notes must be centralized into a few organs, or, if feasible, into one organ ---a plan which will insure effective expansion and contraction of currency and concentration of reserves. Such a note-issuing bank, in order to be safe beyond question and in order to provide safe-guards against any abuse of its vast power through favoritism or speculation, must be carefully restricted in its scope of business. (That is why we could not accept a bill like the Fowler Bill, which practically would create thirty to forty thousand note-issuing National banks, doing at the same time a general banking business, while the smallest and most speculative bank, through the proposed guarantee of deposits, would be as able to attract large deposits as the largest and most conservative bank. Such a measure, although the very antipodes of the Aldrich Bill, would be quite as much in contravention of well established economic principles.) A note-issuing bank in this country should be exclusively a bank of the banks.

C--- No measure would be acceptable which vests the powers of a Central bank in political officers alone, as is the case under our present system. That power, clearly defined, ought to be vested in political officers and business men combined, in a way that would render impossible any political or financial abuse.

D--- No measure would be acceptable which would allow the Government or the banks to issue additional notes without creating at the same time a special gold reserve, composed partly of gold and partly of short term gold obligations. Without such a provision we should create inflation and cause a dangerous weakening of our present standard.

$$ ---[since central banks were first organized in Europe, all the money-panics, all the financial disasters, were caused by money-men !!! and central banks were no help, they only financed wars, never peace]

E--- A bank re-discounting with a Central Bank receives a loan for a given period, and upon this advance it may safely base its own commitments for the accommodations of its customers. The issuing of notes against its assets by a National bank means the creation of additional depositors who may withdraw their money any day like any other depositor. It is unsafe for a bank to accommodate its customers on resources which may be withdrawn at any time. This is a most important and fundamental point.

While carefully observing all the principles outlined in the foregoing, the bill, which is herewith submitted, would, if enacted into law, not interfere at all with existing business habits or institutions. For the time being, its effect would be nothing but the establishment of a central issue department with authority to emit additional notes against certificates of guaranty (twin brothers to the clearing house certificates) and against certain foreign bills of exchange. But this central issue department, or central bank, as I boldly call it, is endowed with all those inherent qualities, in a very embryonic form, which through gradual evolution may make it in years to come, if and as the people decide that they want it, a modern and effective central bank.

Nobody denies the fact that our financial machinery is old-fashioned and entirely insufficient.[$] But ---to use a metaphor--- while our tracks have the wrong gauge, while our rails are too light and our machines too old, and while our lines are disconnected and lack centralization, we could not tear up the whole system at once, nor could we stop increasing our facilities necessary to meet the immediate needs of the country.

A wise manager, however, will conceive a clear plan of the final shape that his railroad must take, and he will plan every detail of new construction so that it will be a useful part of the future system, and so that IT WILL LEAD TOWARD THE FINAL GOAL INSTEAD OF LEADING FURTHER AWAY FROM IT.

As to those on whom the words Central Bank still act as a red rag on a bull, I ask them to study this bill carefully and without prejudice ---if they can--- and they will find not only that this central issue department is surrounded by so many safeguards as to make it more conservative than our present system, but that even Andrew Jackson, were he alive, would not be likely to oppose it.

Paul Moritz Warburg

New York, April, 1908.

$ ---[It was organized, and foisted upon the United States, by your ancestors; in fact, Joseph Seligman, the father of your tag-team partner in this benefiting your new-found homeland, Edwin Seligman, was a key mover and an advisor to Lincoln and Chase. Do not belittle what Belmont and Seligman accomplished in 1863. You're merely adjusting and reorganizing it anyway.]

A SYNOPSIS AND EXPLANATION OF THE BILL

The bill is divided into two sections:

Section "A" deals with the organization of the Central Bank; Section "B" provides for the creation of twenty District Associations with power to issue "certificates of guaranty" to its members against collateral, specifically defined by the bill. The "certificates," which shall be the joint obligation of all the banks comprising such District Association, may be used as security for advances to be taken from the Central Bank by a member of the District Association.

The Bank-District Associations are organized on lines similar to those of Mr. Fowler's Redemption Districts, with this difference, however, that the Fowler bill makes it obligatory for every National Bank to join a Redemption-District Association, and to participate in a general broad guaranty, without collateral, of notes and deposits of other banks; while the bill, as here proposed, not only makes it a voluntary act for each bank (state or national) to join the Association, but provides that the guaranty shall be limited to individual transactions, each of which will be secured by collateral carefully scrutinized in every case.

This would seem to be a more conservative and a more business-like proposition.

A commission of one-quarter of one per cent. per month upon the face value of the "certificate of guaranty" is to be paid by the bank taking out such certificate to the Association issuing the certificate.

The powers of the Central Bank are practically limited to two kinds of transactions: it may deposit money or make advances against certificates of guaranty, at rates to be published from time to time; and it may buy certain short and long bills on England, France and Germany. No bill purchased by the Central Bank and no advance or deposit made by the Central Bank may exceed a period of three months.

The power to purchase these foreign bills is necessary to insure contraction of circulation in times of ease, when the notes can be withdrawn from circulation and the funds of the bank can be invested primarily in foreign bills, easily to be rediscounted and turned into a gold reserve, to be released and used whenever circumstances call for it.[$]

$ ---[Foreign entanglement. Tie the nation's money-supply and finances to foreign entanglement. What is the root-cause of money-panic, stringency in money-supply ? Oh yes, bankers inflating the credit bubble until it bursts, producing boom & bust cycles. So why don't we deal with the root-cause of the problem, instead of tying the nation's finances to foreign money markets ?

Banks can't really be regulated, they can only be closed; but if we want to regulate them, why don't we decree that banks must not extend more credit than they have funds in their vaults to redeem ? Why don't we decree that banks must discount for cash

This is the method adopted by European Government Banks, and any currency legislation which neglects to provide for special funds to be exclusively reserved for investment and handling in a similar way, is unscientific and at the same time dangerous.

It is provided that the stock of the Central Bank shall be owned by the United States for the next ten years. In the eventuality that Congress should deem it advisable, after that period, to have the stock owned by the people, it is provided that the stockholders shall receive the first four per cent., and that of any surplus beyond this sum three-quarters shall go to the Government, in consideration of its guaranteeing the notes of the bank, and one-quarter to the stockholders. This provision is suggested to meet the criticism of those opposed to a Central Bank, for fear that any group of capitalists might buy control of such a bank and use it for its own purposes.

The restrictions placed upon the bank as to the transactions upon which it may enter render impossible any abuse of power by engaging in any illegitimate kind of business, and the limitation of the income from the stock eliminates any inducement to buy the stock for speculative purposes. The stock would become widely scattered all over the country as a Government investment (as in Germany, where a similar method has been adopted). It is proposed to create an additional safeguard by the regulations affecting the election of the Board and of the management of the Bank. The Secretary of the Treasury, the Comptroller of the Currency, the Treasurer of the United States, six members of Congress and the twenty Chairmen of the District Associations would be members *ex officio*. The stockholders (for the time being, the Government) would appoint twelve additional members. This Board would appoint a salaried Governor of the Central Bank.

In this manner the danger of political domination as well as the danger of control by business men, singly or combined, is completely eliminated. Even the most vivid imagination, it is believed, will fail to find any menace in the modified form of a Central Bank, as here proposed.

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only ? This would limit the banks' ability to inflate the credit bubble, would reduce the danger of bank-runs. This would take the nation's money-supply out of the control of bankers !! If we prohibit money-corporations, and allow only full-liability discount-houses and banks, we eliminate 95% of the monetary problems that plagued the United States in the 19th century !!

"Convert all the capital of the country into credit, and all the credit into currency." ---proposed Nicholas Biddle in the 1830s, and you're singing the same tune. Turn everything into circulating medium, and circulate it until we reach escape velocity. Financial transactions to no end, solely for the sake of money-changers.

As for full government ownership of the Central Bank, which you want, in reality, to be a grand central discount house for private banks, using the government's funds as capital, once again, you're humming Nicholas Biddle's melody. He also stated that as long as President Jackson grants a charter, they will like and take it and praise him for it.]

A BILL

Providing for the Establishment of a Central Bank of Issue of the United States and for the Creation of Bank District Associations

AND FOR THE

Issuance and Redemption of Credit Notes Guaranteed by the United States

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BE IT ENACTED by the Senate and House of Representatives of the United States of America in Congress assembled, that

SECTION A.

Section 1. There shall be established in the City of Washington, District of Columbia, a Central Bank of Issue of the United States, with a capital stock of one hundred million dollars.

Section 2. That the Central Bank have succession for the period of fifty years from its organization, unless sooner dissolved in accordance with the provisions of its articles of association, or by the act of shareholders owning two-thirds of its stock, or unless its franchise forfeited for violation of law.

Section 3. That the stock of said Bank be subscribed and paid for and thereafter owned by the United States of America. Such stock shall not be sold by the United States of America for a period of not less than ten years, and, after the expiration of that period, only after a resolution by Congress permitting its sale.

Section 4*a*. That the Central Bank of Issue of the United States shall be governed by a General Council, con-

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On Tuesday, May 5, 1908, Representative Burton of Ohio, at the request of Mr. Warburg, introduced this Bill in the House of Representatives, as a courtesy ---H.R. 21590 providing for the

sisting of 41 members, of whom 12 members shall be elected by the stockholders of the said Bank. The Secretary of the Treasury, the Treasurer of the United States and the Comptroller of the Currency, as well as the Chairman of each of the Twenty National Bank District Associations, to be established in accordance with the provisions of this law, shall be members ex-officio of the Council. Three members of the Council shall be selected by the Senate from its members and three members by the House of Representatives from its members.

Section 4*b*. The members of the Council shall hold office for one year, and until their successors are elected and have qualified. Shares of stock of the Bank held by the United States shall be voted in accordance with the directions of a Committee of both Houses of Congress, to consist of the members of the Finance Committee of the Senate and of the Committee on Banking and Currency of the House of Representatives.

Section 5. The General Council shall elect a Governor, who shall receive a salary of $...,000 per annum. He shall preside at meetings of the Council and shall have general charge of the business of the Central Bank. The General Council shall also elect one or more Deputy Governors to act during the absence or disability of the Governor; their salaries shall from time to time be fixed by the General Council.

Section 6. The General Council shall create such other offices as may be necessary, and shall either appoint the officers and employees or

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establishment of a central bank of issue of the United States, and for the creation of bank-district associations, and for the issuance and redemption of credit notes guaranteed by the United States. It was referred to the Committee on Banking and Currency, and we didn't hear of it again.

The Aldrich-Vreeland act was approved on May 30, 1908. It gave Congress time until June 1914 to pass a bill reorganizing central banking. As Paul Warburg's above remarks indicate, and as is well known from other sources, there were major differences of opinion between the three major banking groups of the United States as to what form the central bank should take. (the three banking groups owned three groups of senators and representatives; passing an act without the approval of the other two groups was impossible)

The Jekyll Island meeting between representatives of J.P. Morgan & Co., National City Bank and Kuhn, Loeb & Co. only took place in November 1910, when a force, powerful enough to effect such meeting, “invited” Davison, Vanderlip, Warburg to weekend together and don't go home until they come to an agreement.

In the June 1908 issue, page 824, *The Bankers Magazine* commented on this bill, without mentioning that it was Paul Warburg's bill: "While we do not approve the central bank plan, for reasons fully set forth in these pages from time to time, we believe that the introduction of a bill of this character will serve a useful purpose in bringing out discussion."

designate the method of their employment; it shall fix the salaries of all officers and employees and direct the general policy of the Bank in conformity with the provisions of this Act.

Section 7. The Governor, Deputy Governors and all other officers and employees of said Bank are hereby prohibited from participation in any syndicates or underwritings and from investing in stocks of any bank or trust company, or from incurring indebtedness in any form, except current bills for living expenses or mortgage indebtedness on a homestead actually occupied as such. Any violation of this provision shall be punishable by imprisonment for not less than years and a fine of not less than $...,000 for each offence.

Section 8. The General Council shall appoint an Executive Committee, to which it may, in its discretion, delegate its powers. This Executive Committee shall consist of the Secretary of the Treasury, the Treasurer of the United States, the Comptroller of the Currency and eight other members. Seven of the members shall constitute a quorum. The Executive Committee shall meet at least once a week.

Section 9. The General Council shall meet at least once in each month, and may be called in special session by the Governor of the Bank.

Section 10. The members of the General Council shall each receive as full compensation for their services the sum of $...,000 per annum, also necessary expenses while traveling on business of the Bank. Members of the Executive Committee shall receive in addition $...,000 per annum, as well as expenses.

Section 11. That at any regular or special meeting, the General Council may, by vote of no less than one-half of its members, issue demand notes of the Central Bank of Issue of the United States in the form of currency payable on demand. Such notes shall be secured by gold bullion or gold coin or legal-tender notes of the United States or by foreign bills, as hereinafter provided, or by certificates of guaranty of the Bank-District Associations, as hereinafter provided. The Bank shall at all times hold an amount of gold, gold coins or legal-tender notes equal to not less than one-third of the aggregate amount of currency-notes outstanding.[$]

The notes of the Central Bank of Issue of the United States shall be guaranteed by the United States of America.[$$]

$ ---[Why tie up gold coins and U.S. notes (greenbacks) and issue notes of this bank in stead ? Oh yes, because by this law we're allowed to print and issue three banknotes for each coin or greenback !!! But when the inevitable hard-times come, you expect the general population, the productive portion of society to assume your responsibility.]

$$ ---[The United States already issues United States notes and guarantees them. If more greenbacks are needed to facilitate daily transactions, Congress may issue more of them and guarantee their redemption. What need is there for notes of a bank, even if

Section 12. All notes issued by the Central Bank of Issue shall be payable on demand in lawful money of the United States, at the office of said bank in Washington, D.C., or at the option of the holder at redemption offices to be designated thereon, and when so redeemed and paid, such notes shall be canceled and destroyed.[$$$]

Section 13. That the Central Bank of Issue of the United States shall have power to deal in gold and silver bullion; to contract for loans of gold at home and abroad, and, when necessary, to give acceptable security for their repayment, to open and to maintain banking accounts in England, France and Germany for the purpose of transactions connected with such bullion operations or with the investment in and the collection of foreign bills of exchange, as hereinafter provided; to make deposits of cash with banks in the United States, provided such deposits be secured by certificates of guaranty of the Bank-District Associations, and to make loans secured by certificate of guaranty. Such advances, whether deposits or loans, shall be for a period not in any event to exceed ninety days, and the aggregate of advances against the certificates of any one District Association shall not exceed the aggregate capital and surplus of the Associations comprising the District Association by which such certificates are issued. All such advances shall be at rates to be fixed and published from time to time by the General Council.

The Central Bank shall have power to deal in, to purchase and to sell, with or without its endorsement, short and long bills payable in England, France or Germany, such bills to run for a period not exceeding ninety days, and to bear the signatures of at least three responsible parties, of which one shall be that of a bank or banker in good standing. The Central Bank shall further have power to receive deposits of Government funds without depositing security therefor, and to transact any and all Government business that may be entrusted to it. The Secretary of the Treasury, the Treasurer of the United States, and disbursing officers of the United States in every branch of service, are empowered to deposit Government funds with the Central Bank, or for its account with its branches, agents or correspondents (if any), without exacting security for such deposits, and such deposits shall be construed, and in the settlement of their accounts shall be allowed, as payments made into the Treasury of the United States.

The Central Bank shall have power to receive deposits from members of the District Associations and the members making such deposits may count the same as part of their lawful money reserve.

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government-owned ? The U.S. may mint and circulate silver coins; they don't even need guarantee of redemption.]

$$$ ---[Once again, the U.S. already issues and guarantees lawful money (greenbacks), why issue notes of this bank, why not discount for greenbacks ?]

The Central Bank shall not loan upon, nor purchase, real estate except for its own banking quarters; nor shall it purchase securities of any kind, except bonds or other interest-bearing obligations of the United States, unless the purchase of such securities shall be necessary to protect the bank in the contingencies contemplated by and subject to the limitations of Section 5137 of the Revised Statutes relating to National Bank Associations, the provisions of which Section are hereby extended to the Central Bank of Issue of the United States.

Section 14. Notes of the Central Bank of the United States may be counted as part of their lawful money reserve by the National Bank Associations.

Section 15. Funds of the United States shall be deposited only with the Central Bank, and no security against such deposits shall be exacted.

Section 16. Notes of the Central Bank shall be received at par in all parts of the United States in payment of taxes, excises, public lands and all other dues to the United States, and also for all salaries or other debts and demands owing by the United States to individuals, corporations and associations within the United States, except interest on the public debt and in the redemption of the national currency. Said notes shall be received upon deposit and for all purposes of debt or liability by every national bank at par and without charge of whatsoever kind.

Section 17. The net profits of the Central Bank, after providing for expenses, bad debts and doubtful accounts, shall be applied as follows: An amount not exceeding twenty per centum of the net profits shall be annually placed to reserve until the reserve amounts to twenty per centum of the capital. Out of the balance of net profits, dividends shall, in the discretion of the directors, be paid on the capital stock to the extent of four per centum per annum. Of any surplus of earnings over such four per centum dividends, one-fourth shall be paid to the stockholders, and the remaining three-fourths to the United States Government.

Section B.

Section 1. That upon the passage of this Act the Comptroller of the Currency shall immediately proceed to designate as the headquarters of Bank-District Associations such Cities of the United States (not exceeding twenty in number) as shall best accommodate and serve the banking business of the country; such Associations shall be consecutively numbered.

Section 2. That within thirty days after the designation of cities to serve as headquarters of the Bank-District Associations the Comptroller of the Currency shall assign every bank (State and National) to one of the Bank-District Associations, and thereupon the Comptroller of the Currency

shall notify all banks that meetings for the purpose of organizing the several Bank-District Associations will be held at their respective district headquarters at a designated place and on a given day. Membership in such Bank-District Associations shall be voluntary and every bank taking part in such organization shall be entitled to only one vote, which shall be cast by an officer of the bank thereunto duly authorized by a vote of the Board of Directors thereof, such authorization to be evidenced in writing and under the seal of the bank.

Section 3. That the Association formed by the banks joining any such District Association shall be known as "Bank-District Association No. ----."

Section 4. That the organization of each District Association shall be perfected by the election of a Board of Managers, consisting of eight members, to serve as follows:

Two of the members for one year; two of the members for two years; two of the members for three years; and two of the members for four years.

The members so elected shall thereupon determine by lot the length of service of each member; each Board of Managers shall adopt rules for the proper conduct of its business.

Section 5. That thereafter on the first Monday in May of every year the banks of every Bank-District Association having joined such District Association shall meet and elect two members to serve for a term of four years, to succeed the retiring members of the Board of Managers. Vacancies in said Board of Managers arising from any other cause than the expiration of a term of office shall be filled by the Board of Managers until the next annual election, when such vacancies shall be filled by a vote of the members of the Bank District Association in the same manner as vacancies through expiration. Special meetings of the members of a Bank District Association may be called by the Board of Managers on giving at least seven days' notice, or such of them, less than a quorum, as may attend any meeting duly called; and special meetings shall be called to fill vacancies in the Board of Managers where the number of such vacancies makes it impossible for the Board of Managers to obtain a quorum or to transact business. At all elections by the members of any Bank District Association, for the purpose of filling vacancies in the Board of Managers, each bank shall vote as prescribed in Section B, Section 2, of this Act.

After any member of said Board of Managers, excepting the Deputy Comptroller mentioned in Section B, Section 6, shall have served a full term of four years, he shall be ineligible for re-election until he shall have been out of office for at least one year.

Section 6. That the Board of Managers, elected as prescribed in Sections 4 and 5, shall on the first Monday of June in each year select a ninth member, who shall thereupon become a Deputy Comptroller of the Currency, and shall act as Chairman of said Board of Managers. He shall give his entire time to the duties of his office and shall serve for one year; and his compensation therefor shall be six thousand dollars per annum, payable in monthly instalments. The Board of Managers, however, may increase said salary, provided that such increase be authorized by the District Association at its annual meeting.

The Chairman shall at any time cause meetings of the Board of Managers to be called on the written request of three of the Managers.

The Board of Managers of any Bank-District Association may by the affirmative vote of seven members expel any of its members, provided that notice of intention to move the expulsion of a member, designating him by name, shall have been given in the call for the meeting. The officer of the Board of Managers charged with the duty of calling meetings shall, at the request in writing of three of the Managers, embody in any call notice of a motion to expel any member of said Board.

Any member of the Board of Managers may resign, and upon acceptance of his resignation and the election of his successor shall cease to be a Manager.

Whenever a member of the Board of Managers of a Bank-District Association shall be a director or an officer of a bank member of said Bank-District Association that has become insolvent or has suspended payment, or that is in default in any obligation to said Bank-District Association, or when a Manager shall have been absent from three consecutive regular monthly meetings of the Board of Managers, unless said absent member shall, previous to such absence, have applied for and received by resolution of the Board of Managers a leave of absence for a longer definite term, not, however, in any event to exceed six months, he shall *ipso facto* cease to be a member of said Board of Managers. He may, however, be re-elected.

Section 7. That each Chairman of a Board of Managers shall, subject to the direction of the Board, have all the authority of the Comptroller of the Currency in respect of the supervision of the members of his particular Bank-District Association, including the power to cause examinations from time to time to be made of any banks comprising his Bank-District Association; and all the decisions of the courts affecting the office of the Comptroller of the Currency shall be applicable to the conduct of the Chairman of the respective Bank-District Associations. For the purpose of securing a uniform system of bank reports, all the banks

shall make reports to the Comptroller of the Currency as now provided by law.

Section 8. That five members of said Board of Managers shall constitute a quorum to do business.

Section 9. That each Board of Managers shall have entire and sole charge of the organization and conduct of its Association, and shall elect and direct such bank examiners as the Board may from time to time deem requisite for the proper supervision of the banks within its district.

All compensations paid to the examiners in the several districts shall be in the form of stated salaries and shall be borne by each Association out of its general guaranty fund.

Section 10. That the Board of Managers of the several Bank-District Associations shall meet at least once every month throughout the year at their respective headquarters. The day of said monthly meetings shall be the second Thursday in every month, unless the Board of Managers shall, by vote, select some other day.

The compensation to be paid to each member of said Board, except to the Chairman thereof, shall be ten dollars for each meeting and actual expenses.

Section 11. That every bank on becoming a member of a District Association shall pay into the Guaranty Fund of the District Association the sum of $1,000, and such annual contribution thereafter as the members of the District Association may at its annual meeting decide. Such annual contribution shall be uniform for all members of the District Association, and shall be not less than $1,000 for each year. The annual meeting shall also pass on applications for new memberships.

Section 12. Any Bank, having an unimpaired capital of at least $50,000, and being a member of a Bank-District Association, composed of not less than 100 national banks (being not less than 50 per centum of the total number of banks in said district), having an aggregate unimpaired capital of not less than $10,000,000 (being not less than 50 per centum of the total unimpaired capital of all banks in said district) may apply to the Board of Managers of its Bank-District Association for the issue to it of a certificate of guaranty to be used by it as security for a deposit by or a loan from the Central Bank, as provided in Section A of this Act, and the Board of Managers of the Bank-District Association may thereupon, in its discretion, after an examination of the condition of the bank, or in its discretion without such examination, and in any event only upon the conditions hereinafter set forth, issue such certificate of guaranty to an amount not exceeding the unimpaired capital and surplus of the bank making such application. Every such certificate of guaranty shall be secured by deposit of collateral security with the Bank-District Association,

which may at any time or from time to time require the deposit of additional collateral or of collateral of different character.

Every bank in making application for the issue to it of a certificate of guaranty must submit a full statement of the collateral by which it proposes to secure such certificate, and the Board of Managers of the District Association shall thereupon decide whether it will issue such certificate, and if so, for what amount and for what length of time and upon what other conditions, if any. Under no circumstances shall such certificates be issued to run for a period exceeding three months, nor for a face amount of such certificate of guaranty at any time exceeding the following percentages of the value of the collateral deposited with the Bank-District Association as security for said certificate of guaranty, that is to say, 75 per centum of the face value of bills receivable (discounted commercial paper) or 95 per centum of the market value of United States Government Bonds, or 85 per centum of the market value of such Bonds of States or Cities, or 75 per centum of the market value of such First Mortgage Railroad Bonds as may from time to time be designated by the Secretary of the Treasury.

Section 13. That should a bank suspend payment, or be in default in maintaining the necessary margin upon its collateral, or be otherwise in any respect in default in any obligation to the District Association, the Board of Managers thereof may, without notice to the bank, sell the collateral for its account. The proceeds of such sale shall be paid into the Treasury of the United States in redemption of the indebtedness incurred by such defaulting bank against the certificate or certificates of guaranty.

Section 14. That every bank shall pay to its District Association, in respect of all certificates of guaranty issued to it, an amount to be equal to not less than one-quarter of one per centum of the face value of such certificates; on all certificates of guaranty, not redeemed after one month from date of their issue, an additional amount equal to one-quarter of one per centum, or such greater amount as shall have been fixed by the Bank District Association at its annual meeting, shall be paid at the beginning of each successive month. Such payments shall constitute a Guaranty Fund for the payment of all losses of the District Association. Any deficit arising in the Guaranty Fund through such losses shall be promptly made good by the members of the said District Association in the proportion of the capital and surplus of each member; the pro rata of each member for the ensuing fiscal year being fixed at the annual meeting. Members paying more than their pro rata shall be entitled to contribution against their fellow members. Amounts paid by members by reason of a deficit or of deficits in the Guaranty Fund shall be repaid to such members out of any

recovery had in respect of the loss or losses by which such deficit or deficits were caused.

Section 16. That the fiscal year of the District Association shall close on April 30th of every year, and that the annual accounts of the Association shall be made up as per this date and shall be submitted to the annual meeting to be held on the first Monday in May.

Section 17. That any bank desiring to withdraw from the Association must give notice of its intention on or before January 1st, and, having given such notice (unless it be withdrawn and the withdrawal be accepted by the Board of Managers), the bank on payment of all liabilities to the District Association, including the surrender to the Bank-District Association of all certificates by it issued to the bank, shall cease to be a member on April 30th following. Any bank so withdrawing shall be entitled to its pro rata share of the Guaranty Fund on the pro rata basis fixed for the last year during which such bank shall have been a member, after making due provision for all unliquidated engagements for which the retiring bank shall be responsible at the time of its withdrawal. All amounts so due shall be paid to the retiring bank, free of interest, on the 30th of April of the year following its withdrawal.

Section 18. That the Guaranty Fund may be invested by the Board of Managers in securities permitted by the laws either of the State of New York or of New Jersey, or of Massachusetts for the investment of Trust Funds of widows and orphans.[$]

Section 19. That all salaries and expenses of the Association shall be payable out of the Guaranty Fund.

Section 20. That the Comptroller of the Currency and the Deputy Comptrollers, Chairmen of the Board of Managers of the respective District Associations, shall meet at least once every six months at such place as the Comptroller may designate, and such regular meetings shall be held on the second Tuesday of April and October in every year, unless the Comptroller and the Deputy Comptrollers by vote select some other day and month.

Section 21. That the Comptroller shall always act as Chairman of said meetings. The said Deputy Comptrollers shall report to the Comptroller all violations of law and shall give him such other information as he may from time to time call for. Except as herein provided the Comptroller shall continue to exercise all the authority and powers now exercised by him.

Section 22. That any Bank-District Association may at any regular or special meeting of the Association, by affirmative vote of a majority of all members of such Association, cause the organization of its members

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$ ---[You just couldn't leave the widows & orphans out, could you ?]

into Bank-Sub-District Associations, fixing the number of Sub-District Associations and assigning each of its members to one of said Sub-District Associations. Such Sub-District Associations shall be so formed that the members of each Sub-District Association shall be located in contiguous territory, and all banks in any one city or town shall be assigned to the same Sub-District Association. Such action by any Bank-District Association shall be submitted to the Comptroller of the Currency, who shall transmit the same with his recommendation in regard thereto to the Secretary of the Treasury, and upon approval of such action by the Secretary of the Treasury, the same shall become effective. Bank-Sub-District Associations shall be organized and administered in the same manner as Bank-District Associations, and all the provisions of this Act relating to Bank-District Associations shall in every respect apply to Bank-Sub-District Associations, except

that certificates of guaranty issued by any Bank-Sub-District Association shall be used only as security for certificates of guaranty to be issued by its Bank-District Association. Each Bank-District Association shall, at its annual meeting, fix what proportion of the monthly charge, if any, shall be paid by the Sub-District Associations to such District Associations for the issue by it of its certificates of guaranty.

Section 23. That all Acts or part of Acts inconsistent with the provisions of this Act are hereby repealed.

NOTE:

A separate Act would have to be passed for the appropriation of funds for the acquisition of the shares of the Central Bank by the United States of America.

52 & 54 WILLIAM STREET,

May 8th 08.

My dear Edwin,

If I could frame a copy in gold for you, I would do so. As I can't, accept my heartiest thanks instead.

Yours in a hurry but

Cordially

Carnegie.

Warburg, Paul M.

A modified central bank of issue

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GRAHAM K SHAW
207 E. 14th 094787
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APR 22 1965 ren

THE FEDERAL RESERVE SYSTEM

ITS ORIGIN AND GROWTH

Reflections and Recollections

BY

PAUL M. WARBURG

In Two Volumes

TO THE GUARDIANS
OF THE
FEDERAL RESERVE SYSTEM
PAST, PRESENT, AND FUTURE
THIS BOOK IS DEDICATED

NEW YORK
THE MACMILLAN COMPANY
1930

FIRST ATTEMPTS AT BANKING REFORM

Without a central organization, which by discounting or buying commercial paper could furnish additional currency or additional reserves, a heavy rise in deposits or a marked increase in the volume of circulation were bound automatically to tie up the banks.[$] It is true that certain elasticity was provided by the willingness of European bankers to grant us acceptance credits. These credits served to finance the movement of our crops and, in the form of finance bills, to provide for the additional demands of industry and speculation. But when these credits became exhausted, the mere knowledge that the end of the tether had been reached created a situation of such tenseness that a slight shock could cause the collapse of the insecure structure. When, in such circumstances, Europe would attempt to curtail credits, or draw gold, or when the depositor would become alarmed and begin to hoard it, when the vicious "gold premium" would put in its dreaded appearance ---pandemonium was inevitable. With no central institution to provide relief, nobody could strengthen his position save by attacking his neighbor. Thus natural instincts of self-preservation, when called into play, unavoidably led to panics and wholesale destruction of values. When the frantic attempt to sell securities at my price, while nobody was in a position to buy, precipitated a crash which at times forced the stock exchange to close its doors, stock-exchange call loans "froze." That meant the liquid reserves of the banks in all parts of the country had become immobilized and that a

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$ So, the credit-bubble ---generated/inflated by banks issuing and circulating credit many times over what they had the funds to redeem (to make good on the promises to pay actual money on demand)--- went puff, and the airship of printing-press credit hit the ground with loud noise. Now, instead of allowing the market to take its course and enforce upon them bankers the consequences of their ir-responsible/criminal actions of making false promises, you want to bail them out and force the general public, the actual producers in the country, to assume the responsibility and pay for the crimes of money corporations. You want to issue and circulate more credit ---based on nothing but the good name of the central bank and the citizens' ability to pay interest on the debt--- to ease the money-panic caused by the over-issuing of credit !?! (you learned well the age-old family secret of the parasites)

Who caused the money panic ? Was it hoarders who lock up silver coins and Treasury notes under the floor-board ? Was it farmers recklessly producing more food than the people can eat ? Was it factory workers ? Was it small operators ? Was it large factories ? Was it drunken sailors spending every penny on riotous living ?

Bankers and their speculator friends are the only ones who can, and do, produce money panics; and they produce one in every decade !! What should we do to avoid money-panics ? Establish a bigger bank with a bigger printing-press ?

Or, try a new experiment ? Deport all these experts and theologians; establish an independent Treasury and be our own fiscal agent, without the good-offices of a central bank; keep the control of the currency and its volume in our hands; treat bankers who issue false promises the same way we treat those who issue bad cheques.

general suspension of cash payments was inevitable. Within the confines of a city, banks might make efforts to settle, at least the most pressing transactions, by accepting clearing-house certificates in settlement with one another. Outside of this narrow circle, however, payments between cities and sections entirely ceased, as banks refused to ship currency and declined to accept payments in checks on other cities. It was one of the tragic defects of the American banking system at that time that, while disasters of this kind were the automatic consequences of over-expansion, there was no possibility of averting them by timely preventive collective action. There was no governmental or private authority that could assume leadership in warning the country, or that had actual power to put on the brakes if the cars were moving too fast and heading for the precipice.

Individualism in banking demanded that everybody should be free to have his own individual fling, while the subsequent disaster was the common property of all, engulfing the innocent with the guilty. At times, when excesses had not gone too far, the unwillingness and inability of the banks to make further loans ---which might express itself in interest charges of from 50 per cent to 100 per cent for call loans--- would bring about a contraction; at times, the very existence of such rates would tend to broadcast the critical underlying conditions and precipitate the panic that it was hoped such prohibitive would forestall. Everybody will agree today that it would be difficult to imagine a banking system more cruel and more inefficient than that prevailing in the United States at the beginning of the twentieth century ---a system which, instead of scientifically regulating the flow of credit and money, so as to secure the greatest possible stability, was designed automatically to produce instability; a system which permitted expansion and contraction to go unhampered to their very extremes; a system which knew no better way to turn the ebbing tide of credit than to lay the country waste making its ruins an attractive shopping place for domestic and foreign wreckers and bargain hunters.[$]

It is very important, however, to realize how little the people of that period understood the fundamental organic defects of their banking system. American public opinion wrongly inclined to dispose of the

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$ Same old same old. Who inflated the credit-bubble ? The bankers, the money corporations !! None of the money-panics would have occurred if money corporations had been prohibited, and only full-liability discount houses and banks allowed; if they had been required by law to pay out only coins or Treasury notes. Bankers went into the banking business specifically to print money, and exchange it for real value.

The credit system is the problem, the fatal flaw ! That is what we have to eliminate !! The credit system can only produce financial disasters and money panics --- that is its nature. You may regulate it all you want, may dress it up in pretty laws, may perfume it with fragrant regulations, the stench of it remains the same, it will act out its nature and produce the same result.

question by laying the blame for these difficulties upon the "selfish and reckless management of corporations," on "over-speculation," the "greed of banks," or the wily practices of "Wall Street."[$]

To a person trained under the central banking system of European countries, such conditions seemed bewildering and strange. To him American banking methods appeared to do violence to almost every banking tenet held sacred in the Old World. In Europe, reserves were centralized, note issues were elastic, and commercial paper permitting of immediate sale formed the quickest asset of the banks. In Europe, the "bill market" formed the most important field in which banks sought to employ their liquid funds, while a certain limited portion of their secondary reserves were invested on the stock exchanges in fortnightly or monthly loans under the term-settlement system generally prevailing on European stock exchanges, instead of a daily-settlement system such as that in vogue with us. In the United States, the note issue, based on government bonds, was inelastic, gold reserves were decentralized, and investments in unsalable single-name commercial paper were locking up the funds of the banks, while call loans on the stock exchange constituted their chief liquid asset.[$$]

The idea of a central banking system being anathema to all, attempts to obtain relief generally centered in proposals for the creation of more currency to be issued by thousands of individual banks. What the general state of mind was with regard to the banking problem may well be illustrated by a conversation I had shortly after my arrival.

$ Yes. How dare them backward, unschooled agrarians, them peasants, lay the blame where it belongs ---the criminals who issue false promises to pay.

But, luckily for all Americans, Moritz Warburg selflessly transplanted himself into the United States, just to help the long-suffering citizens out of their misery ---the kind-hearted humanitarian benefactor he was.

$$ In Europe the banking circle of friends held the fields from day one. Banking friends obtained charters from kings before the fields could be populated by wildcat enterprisers. In the U.S., neither the Frankfurt friends, nor the London friends were strong enough to prevent other money corporations from springing up. Plus, in America the London friends and the Frankfurt friends were in competition with each other (and supported local enterprisers as long as these enterprisers were opposed to their opponents).

The National currency Bank System that prevailed at the time Moritz blessed the United States by his taking up residence, was organized and foisted upon the U.S. by August Belmont and Joseph Seligman, bankers to the United States and financial advisor to Abraham Lincoln and Portland Chase. Secretary Chase didn't just come with a brand-new concept on his own ---a concept and system which was the Bank of the United States in a different organizational form. In 1862 the farmers, the city workers, the trades men, didn't ask for a new banking system. The Independent Treasury System seems to have worked just fine between 1846 and 1861. Only a certain banking fraternity wanted a new system; other bankers merely wanted to eliminate the independent treasury concept.

Edwin Seligman is now finishing what his father, Joseph, started. In 1863 only so much could be accomplished, so they did what they could by taking the first step. In 1913 more can be done, so it is time to put in the capstone.

In order to clarify the problem as it had arisen in my mind, I had ventured to set down, in a short memorandum, the cardinal defects of our system as I saw them. I compared our methods with those employed in Europe and pointed out the direction in which, I believed, the remedy might be found. I stressed the fact, however, that, aside from psychological and political resistance, any attempt to establish in the United States a banking system more nearly approaching the European models would meet a serious and almost insuperable obstacle in the fact that while central banking systems in Europe were largely built upon a foundation of modern commercial paper and bankers' acceptances, these modern forms of paper were then non-existent in the United States, and that, therefore, progress would be achieved only by slow degrees.[$]

This memorandum was shown to Mr. Jacob H. Schiff,[*] then the senior partner of the banking firm of Kuhn, Loeb & Company, of which I had lately become a member. Mr. Schiff read the paper with interest and told me, what afterwards he often repeated, that, while theoretically he agreed with most of the thoughts expressed, he believed that I was misjudging the psychology of the American people, who would never, he said, accept any system approaching a central bank. But since he always appreciated earnest efforts on the part of his juniors and never missed an opportunity of encouraging them, he suggested that I let him show the paper confidentially to two of his friends. One of these was Mr. James A. Stillman,[**] President of the National City Bank of New York. It was significant, however, of the atmosphere in which we were then living that Mr. Schiff warned me to be careful not to have the memorandum go any further, lest, having just arrived from Europe, I might impair my standing

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$ ---[What's with this use of "our" ?

Was there a request by the farmers, the city labourers to invite a benevolent expert, a gift from the generational money-changers, who would selflessly dedicate himself to organizing a modern, scientific money-corporation system for them ?

In the 1870s, 1880s, 1890s, the productive people in the United States continuously requested the minting and using of silver coins as unit of account and common coin of the realm, and the curtailment of the activities of bankers !!!

Money corporations in the U.S. hired every newspaper, every senator, every representative they could, to prevent the american workers from getting what they asked for. Bankers and their friends installed RB Hayes as President by election-fraud; New York bankers bought & paidfor drunkard Cleveland to betray the voters into the hands of Frankfurt bankers, and in 1893 administered an object-lesson to the nation to achieve their goal of eliminating the silver-purchasing clause; they conducted a campaign of threats, fear and violence in 1896 to install their man McKinley into the White House.

It was money-corporations that asked, since the 1870s, for "elastic" (india-rubber) banknote circulation, and bank-asset-based banknotes.]

* Jakob Heinrich Schiff (1847-1920), born in Frankfurt; blessed the U.S. with his presence in 1865.

** ---[This is a typo. Warburg must be referring to Jewett Stillman (1850-1918), not Alex Stillman (1873-1944). Alex Stillman didn't become president of National City until 1919. Alex Stillman was 5 years younger than Moritz Warburg.]

in the banking community by creating the impression that I was urging a system which, in the final analysis, would have to be built around a central banking organization. I gladly accepted Mr. Schiff's suggestion, and a few days afterwards I found Mr. Stillman standing over my desk. He looked at me silently, as was his wont, through his half-closed, heavy dark eyes.

"How is the great international financier?" he asked with friendly sarcasm. He then added, "Warburg, don't you think the City Bank has done pretty well ?"

I replied, "Yes, Mr. Stillman, extraordinarily well."

He then said, "Why not leave things alone ?"

It was not without hesitation that I replied, "Your bank is so big and so powerful, Mr. Stillman, that, when the next panic, comes, you will wish your responsibilities were smaller."

At this, Mr. Stillman told me that I was entirely wrong, that I had the mistaken notion that Europe's banking methods were the most advanced, while as a mater of fact, American methods represented an improvement upon, and an evolution of the European system, America having already discarded its central bank. He had no doubt that progress would have to be sought not by copying European methods, but by elaborating our own.

Four years later, in the midst of the panic, I found Mr. Stillman once more standing over my desk; and when I looked up, he asked, "Warburg, where is your paper ?"

I said to him, “Too late now, Mr. Stillman. What has to be done cannot be done in a hurry. If reform is to be secured, it will take years of educational work to bring it about.” [$]

This incident is related for the sole purpose of showing the status of banking and business opinion in those far-off days. What Mr. Stillman had said was typical of the general attitude then prevailing.

At this juncture, the United States Senate was dominated by the Republican “Old Guard,” of which Senator Aldrich was the all-powerful head. This group believed in bond-secured currency and, at a pinch, in still more bond-secured currency. In times of emergency, further relief was to come from Treasury deposits, as long as they were available (the government borrowing as far as it had the power to do so). As a last resort, when panic was imminent, or had actually set in, clearing-house certificates were to be issued.

There were other groups in Congress which advocated so-called asset-currency plans. Representatives of this school of thought were

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$ ---[If Stillman didn't know that the 1907 money-panic was artificially and purposely generated, then he knew nothing. If Stillman didn't know that the solution to the 1907 money panic was NOT a central bank, but the dealing harshly with JP Morgan Co. and other money corporations, then what did he know ?]

moving on sound lines, when proposing to make commercial assets the basis of circulation. They were preaching unsound doctrines, however, when they urged that individual commercial banks should be authorized to issue notes against their own assets, and that they should be permitted to do so without providing a safe machinery for securing such notes and redeeming them in gold. Under such plans the weakest bank would have been allowed to put its notes into circulation alongside the strongest, and proposals for the guarantee of deposits were the logical corollary of such schemes (Fowler Plan). It is an amazing fact that commercial organizations and bankers' associations of that time favored such asset-currency plans in one form or another.

To complete the picture, it ought to be added that there was also at that time a powerful faction in Congress which stood for the theory that "the issue of money is the function of the government," and only a few years had elapsed since the champions of free silver had alarmed world by their sixteen-to-one proposal.[$]

After its first glimpse of daylight, my initial memorandum, like a ground hog, went back into the still darkness of my desk until, when banking conditions looked very critical, at the close of 1906, I was invited to write an article for *The New York Times*. I then elaborated the ideas I had expressed in my memorandum and, in its revised form, the article was published on January 6th, 1907, under the title "Defects and Needs of our Banking System."[*] The article was primarily an argument for the creation of modern American double-name paper, a discount market, a central note-issuing organization, and an appeal to bankers to coöperate, at least to the extent of modernizing their conceptions with respect to accepting and endorsing. It also contained an argument urging the consideration of term settlements on the New York Stock Exchange, in order to discontinue the excessive use of the country's surplus funds on the stock exchange's call-loan market and to deflect a substantial portion of these funds into a discount market.

$ Yes, all them pagans, heretics and heathen and unclean unbelievers, who didn't learn about money-printing in the Frankfurt school of internationalist finance. The agrarians and peasants and loco-focos who subscribed to the un-scientific and un-modern notion that bank and state should be separate; that it is possible to live life and prosper without bank-notes and bank-credit; that the Treasury and the nation's finances shouldn't be farmed out to internationalist bankers ---just as the Navy is not farmed out to privateers, nor should the Treasury be farmed out to pirates.

* *Defects and Needs of Our Banking System*, The New York Times Annual Financial Review, January 6th, 1907; Essays on Banking Reform in the United States, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 9.

In connection with a suggestion for the creation of a uniform issue of bank notes against the deposit of legitimate commercial paper, the following thought was expressed:

> Certain committees would have to be appointed in every reserve and central reserve city in order to scrutinize the bills deposited as security by the banks. *These committees might be the predecessors of future local committees of a central organization*.

To attempt to give an adequate description of the panic which occurred in 1907 would lead us too far afield. October of that year, with the weeks of slaughter and despair following the failure of the Knickerbocker Trust Company and the run on the Trust Company of America, will always remain vivid in my mind. Banks and individuals with hundreds of millions in call loans at their disposal could not save those that were drowning. As already mentioned, without a central reserve organization and without an elastic note issue, one bank could only strengthen itself by weakening another, and any attempt to call in funds from a debtor would only throw him into desperate confusion and set in motion a chain of further embarrassments and insolvencies.

In the midst of the panic, on November 12th, 1907, when the gold premium was at its highest, and when all possibilities of making settlements between cities had ceased, I published a paper entitled *A Plan for a Modified Central Bank*.* In this paper, it was proposed to create a bank at Washington, endowed with a capital of from $50,000,000 to $100,000,000, partly paid up, and to be owned, one-half by the government, and one-half by the national banks. The management was to be in the hands of a salaried president or presidents, to be appointed by the board of directors; the board itself was to consist of delegates from the various clearing houses, the Secretary of the Treasury, the Comptroller of the Currency, both *ex officio*, and some additional directors to be appointed by the stockholders and by the chambers of commerce and the Supreme Court (the latter suggestion rather an evidence of my insufficient acquaintance, at that time, with these American institutions). The object in mind, however, is clearly shown in the following paragraph:

> It is intended merely to show how it is possible to create a board which would be independent of politics, which would comprise men of business knowledge and experience, and which, by its composition, would afford a reasonable guarantee that it would not be swayed by selfish motives in its actions.

The proposed bank was to establish a general rate of interest, to be modified from time to time, at which it would allow advances of money

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* *A Plan for a Modified Central Bank, Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 29.

against clearing-house certificates. There were also provisions enabling the bank to buy three months' paper, bearing at least three signatures, payable in dollars or in certain foreign currencies. Authority for the government bank to buy three months' paper, bearing at least three signatures, including a bank's or a banker's endorsement or acceptance, it was stated, was needed for the purpose of encouraging the creation of such paper, the lack of which was one of the main causes of the immobilization of the resources of American banks.

The following is a quotation from this *Plan for a Modified Central Bank*:

> The Government Bank would act as the clearing house for the clearing houses.
>
> It is not beyond the bounds of imagination that local boards for branches of the Government Bank in the various cities could be established, taking the clearing-house committee, or some members thereof, as a nucleus around which some other independent members might be added. It is also possible that these agencies would receive moneys in one city in order to pay them out in the other ....
>
> We need some centralized power to protect us against others and to protect us from ourselves, some power able to provide for the legitimate needs of the country and able at the same time to apply the brakes when the car is moving too fast. ....
>
> We should aim to transform our commercial paper from a non-liquid asset into the quickest asset of our banks. This change, however, is so far-reaching that it would take years of educational work to carry it out, while relief should come at once. .... Instead of giving vast and vaguely defined powers, properly belonging to a central bank, to one or two political officers (the Secretary of the Treasury and the Comptroller of the Currency ---*Author*) and instead of putting the burden and responsibility on them alone, we should define the power and responsibility clearly and should associate with our political officers in bearing it a large body of our best-trained business men. This would mean a democratic, a conservative, and a modern way of self-government.

In the turmoil of their daily struggles for survival, it was only natural that bankers did not find time to study this plan. Indeed, in that time of panic, they could hardly have been expected to do so. Looking backward to-day, however, it seems that had it been possible to arouse Congress to quick action along the lines proposed, prompt relief might have been secured, and a great deal of trouble might have been prevented.

But as far as the problem of devising remedial financial legislation was concerned, the Senate and the House of Representatives were, at that time, wide apart. The Senate was wedded to Senator Aldrich's proposal for the issue of additional notes against government bonds and other

corporate obligations, while the House was endorsing a proposal of the Hon. Charles N. Fowler for an "asset currency" ---a proposal which involved the creation of "currency associations" coupled with a provision for the "guarantee of deposits."

It was inevitable that, after the panic, the general interest in the question of banking reform should become very keen. In January, 1908, under the leadership of Professor Edwin R.A. Seligman,[$] a series of lectures upon the banking problems of the hour was arranged at Columbia University. I was invited to join this forum and delivered an address entitled *American and European Banking Methods and Bank Legislation Compared.*[*]

This address dealt with the problems covered in the earlier articles referred to above; but for the first time, the "concentration of reserves" was urged. While one thousand millions of dollars were lying idle in our banks and trust companies as so-called reserves, that is, as the final resort in case of need, this money, by virtue of the law, could scarcely be touched. But what, my audience was asked, was the use of such reserves if they were not available in emergencies and times of need and if, even in contravention of the law, they could not be used by one bank without fear of being ruined, unless all banks agreed to coöperate in using them freely ? The inevitable conclusion was emphasized that the road to reform lay in the direction of concentration of reserves, and in the co-operation of the banks under the leadership of one central organization.

Although it is twenty years since this address was delivered at Columbia University, certain passages contained in it may have an interest not altogether outworn, as, for instance, the following:

> We cannot have an effective modern central bank, because there are no modern American bills of exchange, and we cannot create a sufficient amount of modern paper without a central bank. We cannot have stock-exchange settlements without the abolition of the usury law; but even after its abolition we must have a bill market before we can do away with daily settlements and call loans, based on these daily transactions. Nevertheless, every one of these changes will have to be effected some day, and it is all-

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$ Edwin Robert Anderson Seligman (1861-1939); son of Joseph Seligman (1819-1880) who was born in Baiersdorf and blessed the U.S. with his presence in 1837. In 1863 Joseph Seligman from J.&W. Seligman --- Seligmann & Stettheimer became banker to the United States and sold $100,000,000 U.S. bonds in Frankfurt. August Belmont and Joseph Seligman were the advisors behind Portland Chase's newly invented banking system that was unleashed in 1863. Edwin and Moritz are now adjusting and reorganizing the National currency Bank System with which the illustrious ancestors blessed the U.S.

* *American and European Banking Methods and Bank Legislation Compared. The Currency Problem and the Present Financial Situation*, Columbia University Press, 1908; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 39.

important that each successive step in currency and banking reform be made with this end in view.

From this standpoint it is evident why neither the Aldrich Bill* nor the Fowler Bill can be deemed to be a step in the right direction. Every measure is bad (1) which accentuates decentralization of note issue and of reserves; (2) which uses exclusively bonds as a basis for additional circulation; (3) which gives to commercial banks power to issue additional notes against their general assets without restricting them in turn in the scope of their general business, and without creating some additional independent control, endorsement, or guarantee; (4) which gives arbitrary powers exclusively to political officers, often untrained in business, and usually holding office only for a short period.

A central clearing house, with power to issue against clearing-house certificates notes to be guaranteed by the United States, would, in my judgment, form the best solution for the time being. The creation of a central clearing house with a capital of its own and with a limited dividend, the surplus revenue going to the United States, would leave present conditions undisturbed, and, while offering immediate relief, would at the same time form a sound basis for future developments.

It is unnecessary to repeat in detail the arguments for the organization of the central clearing house and the enumeration of its powers which were given in this address.**

This Columbia University address became the subject of a number of editorials and stimulated a good deal of interest among bankers and business men in the problem of remedial financial legislation.

An exchange of letters took place in the spring of 1908 between Mr. Herbert Parsons, Mr. Theodore E. Burton, and myself. Both of these gentlemen were at that time members of the House of Representatives. Some passages from a letter I addressed to Mr. Burton throw light upon the legislation then under discussion.

New York,
March 30th, 1908.

The Hon. Theodore E. Burton,
House of Representatives,
Washington, D.C.
Dear Mr. Burton:

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* This "Aldrich Bill" of 1908 must not be confused with the "Aldrich Bill" of 1912 proposing the National Reserve Association legislation. ---*Author*.

** I thought it best to use the clearing-house organizations as the basis for the first steps towards monetary reform, because the banks were familiar with their operations; and, by choosing the form of a central clearing house, I hoped to avoid the central-bank controversy, which would have involved interminable delays.

According to your desire I have studied the question how to amend the Aldrich Bill so as to embody in the same the clearing-house certificates as a basis for issuing additional circulating notes ....

My draft of the bill as it stands now is rather amusing, because one cannot imagine two bills more opposed to each other than the Aldrich and the Fowler Bills, and still by welding both together with comparatively few changes we get a bill which takes away the radical features of both of them and contains enough of both measures so as to make them appear as a compromise to both contending parties. ....

It would be carrying coals to Newcastle were I to try to tell you why this bill, as suggested, would be superior to the Aldrich Bill, and why it is more conservative than the Fowler Bill, while it retains the good principles of the Fowler Bill of basing additional currency on commercial assets. What I like about my bill is the fact that it will remain a voluntary act for each bank to join the association and that each guarantee will be given after full examination, and that these guarantees will be well defined and limited, instead of a wholesale guarantee for uncontrolled business.

While I think that a bill of this kind would be a big step in advance, as against the bills proposed by Senator Aldrich and Mr. Fowler, it is to my mind not the ideal bill as it maintains the principle that commercial banks are, at the same time, note-issuing banks, and as it increases this note-issuing power which, once established, it will be difficult to take away again. If the two Houses would take candidly to a scheme as outlined in the enclosed bill, it may perhaps be possible, at the last moment, to go one step further, and create a bank in Washington, the stock of which would, at the beginning, be entirely owned by the government, and let this bank, which can be governed partly by political officers, and partly by business men, issue the notes against the certificates of guarantee, instead of allowing the national banks to issue this circulation. The difference, for the time being, is a very small one; but as a stepping stone for the future the importance is immense. It would establish a right principle, and besides such a scheme could *embrace not only national banks but state banks, possibly also trust companies, which would become members of the district associations, while both the Aldrich and the Fowler Bills, no matter how amended, can only deal with national banks*.

Yours very truly,
Paul M. Warburg

The legislation under discussion finally took the form of the bill which passed into law as the Aldrich-Vreeland Act. This bill constituted a compromise somewhat on the order of the one discussed in the letter above. It permitted the issuing of emergency currency against the deposit of government ---and certain corporate--- obligations and of commercial paper guaranteed by certain currency associations to be organized under the authority of the law. Unfortunately, however, Senator Aldrich

succeeded in inserting a provision to the effect that national banks, before being permitted to avail themselves of the privilege of issuing notes against commercial paper, should be required first to take out a certain amount of circulation secured by bonds.

My correspondence with Mr. Burton and with Mr. Parsons finally led me to send Mr. Burton a draft of a bill, in the formulation of which I had the advantage of the collaboration of my late friend, Albert Strauss, who subsequently succeeded me as member of the Federal Reserve Board. This bill was sent to Mr. Burton in pamphlet form and was entitled *A Modified Central Bank of Issue: A Suggestion of a Bill*. Accompanying the bill, I sent a letter to Mr. Burton under date of April 30th, 1908 (see Appendix One), asking him to introduce the bill in the House "by courtesy," and he complied with my request.

For convenience, the bill, as introduced by Mr. Burton, has been reprinted in Volume Two.* It will be noted that the bill contained the express provisions that balances of member banks with the central bank of issue should be counted as reserves of member banks, and that the notes of the central institution should be counted as reserve money in the hands of the member banks. To the best of my knowledge, these two suggestions were novel at that time.

The pamphlet in which this draft of a bill first appeared contained a preface which gave a synopsis of the provisions of the bill and which stated certain facts and fundamental principles to be recognized in dealing with the question. They were:

First, that the United States must finally develop some kind of a central bank system, giving the country an elastic currency payable in gold and based on modern commercial bills, a system similar in principle, if not exactly alike in form, to those of the important European central banks.

Second, that, while this must be the final aim, our political, legal, and economic conditions preclude the possibility of creating an institution with powers and efficiency equal to those of the European government banks.

Third, that, therefore, we shall have to be satisfied to advance slowly, fully realizing that what we create now can only be an initial step. *But it must be a step in the right direction, a measure which has clearly in view the final aim and which does not neglect any of the fundamental principles on which modern central bank systems have been erected in other countries*.

Two passages dealing with the legislative proposals then under discussion may be of interest and are quoted in full:

No measure is acceptable:

* *Modified Central Bank of Issue: A Suggestion of a Bill*, New York, 1908. Vol. 2, p. 71.

(*a*) Which bases currency on long time obligations, like the Aldrich Bill.

(*b*) Which would tend still further to decentralize the power of issuing notes, and which would vest this power in banks doing a general commercial business. The issuing of notes must be centralized *into a few organs, or, if feasible, into one organ* ---a plan, which will insure effective expansion and contraction of currency and concentration of reserves. Such a note-issuing bank, in order to be safe beyond question and in order to provide safeguards against any abuse of its vast power through favoritism or speculation, must be carefully restricted in its scope of business. (That is why we could not accept a bill like the Fowler Bill, which practically would create thirty to forty thousand note-issuing national banks, doing at the same time a general banking business, while the smallest and most speculative bank, through the proposed guarantee of deposits, would be as able to attract large deposits as the largest and most conservative bank. Such a measure, although the very antithesis of the Aldrich Bill, would be quite as much in contravention of well-established economic principles.) A note-issuing bank in this country should be exclusively **a bank of the banks**.

On the front page was printed President Lincoln's campaign speech at New Salem—for which I was indebted to my friend, the late General James H. Wilson of Wilmington, Delaware—as follows:

Friends and Fellow-Citizens:
I am plain Abe Lincoln. I have consented to become a candidate for the legislature. My political principles are like the old woman's dance—short and sweet. I believe in a United States Bank; I believe in a protective tariff; I believe in a system of internal improvements, and I am against human slavery. If on that platform you can give me your suffrages, I shall be much obliged. If not, no harm done, and I remain, respectfully yours,

Abe Lincoln.

---

* James Harrison Wilson (1837-1925)

What exactly did Abe Lincoln say ?

"Lincoln returned to New Salem just two weeks before the August [1832] election, and immediately returned to campaigning for the State Legislature, which had been interrupted by the Black Hawk War. He made very few speeches, but at Pappsville, a town just west of

You take a steaming pile of money-corporation banking; dress it up nicely, decorate it with christmas ornaments, put it in colourful packaging --- it still is the same pile of printing-press credit circulation, no matter how eloquently you phrase the law pretending to regulate the credit-system.

>>>>> "elastic currency payable in gold and based on modern commercial bills"

Really ??!! Elastic gold ?! And no one in the audience, or in the newspapers where this flummery was reprinted, would stand up and tell you to stop impressing the ignorant. You want to issue 10-50 times more solemn promises to pay gold on demand than you have coins in your vaults ! You want to discount a 100 times more than your paid-in, existing capital. Then, when the result of the credit system hits the fan you want to blame every dick and harry, but never yourself and your money-corporation credit system !!

The root-cause, of course, of all this lack of liquidity and inability to redeem notes, was/is the money-corporations' habit of issuing and circulating way more credit than they have/had the ability and willingness to redeem. The age-old practice of inflating credit bubbles always produces the age-old results of money panics. People suddenly realize they need actual money, and that the promises are false, they try to get their money from those who solemnly promised to pay them money on demand; but the vaults are empty, there is no actual money (and the bankers wouldn't give

---

Springfield, a large crowd asked him to speak. According to A.Y. Ellis, a New Salem merchant, Lincoln responded with the following remarks:

'Fellow citizens, I presume you all know who I am ---I am humble Abraham Lincoln. I have been solicited by many friends to become a candidate for the legislature. My policies are short and sweet, like the old woman's dance. I am in favor of a National Bank [Bank of the United States], I am in favor of the Internal improvement system [huge government borrowing and indebtedness], and a high protective tariff [for the benefit of internal monopolies]. These are my sentiments and political principles. If elected I shall be thankful; and if not, it will be all the same.'

"Lincoln lost the election of 1832, but he gained an enthusiasm for politics that would always remain with him. There were 13 candidates in this election, and out of a total of 8,315 votes cast, Lincoln received 657 votes. Of the 300 votes cast at New Salem, Lincoln received 277."

After Jackson's neutralizing the Bank of the United States in 1832 and 1833, the member states went on a borrowing spree with a vengeance, and by 1839 member States owed $170,000,000.00 (out of which $52,000,000 was borrowed for the purpose of setting up banks). In 1839 the government debt of Pennsylvania stood at $27,306,790.00, higher than the debt of any other member State. In 1839 the Federal government had no debt.

them actual money even if they had some, they just suspend payments), and there is a danger of these fine banks going out of business.

According to the theology of bankers, the truth about the banking industry must never be admitted. Moritz Warburg in his 700-page book, of course, don't want the inherent mortal flaw in the business of money-corporation banking hinted at, much less examined thoroughly.

There is a reason why money corporations are organized, and it is not service to the public. Facilitating payments and transfer of money, facilitating the lending and borrowing of existing, accumulated money could be done by the Post-Office or a Western Union. That is not what the money corporations want, they didn't go into business to provide service, there is no money in that. They want to issue and circulate credit, and eventually exchange this printed up credit for real value; that's where the money is.

If industrial and agricultural producers wanted a place where they can discount notes they received (because they don't want to wait for 90 days), a few full-liability Discount Houses, paying out cash only, will rise to the occasion.

Mr. Vanderlip was honest and blunt when he simply put it before the Senate committee why money corporations want a central bank:

"In order to have a discount market you have got to make liquid the commodity you sell there; that is, commercial paper. You can only do that by having a central bank, to which the purchaser can go to rediscount. A central bank is necessary for the creation of a discount market, and the discount market is the place where surplus funds will be invested."

That is what the bankers want. To arrange the economic life of the nation in such a way that producers cannot exist without the good offices and services of money corporations.

How has Mr. Warburg's most modern, most scientific Federal Reserve performed in real life ?

After commencing operations, the Fed financed the war. When the war was over and the credit-bubble went puff, the Fed didn't help the farmers and the city workers by easing the money-famine. Elasticity is only for money-corporations, not for the producers.

Then came the roaring 1920s ---the new economy, the nowhere to go but up exuberance. What did the Fed do ? Did it curtail the astronomical expansion of credit in the shape call-loans ? No !!! When the credit-bubble exploded, has the Fed helped to end the money-famine ? No !!

Has the Bank of England helped the producers in England during the Depression by providing them elastic currency ? No !!

How about the Bank of Germany ? In the 1920s that bank did nothing while the producers were wiped out through inflation. In the 1930s there was a very different management in Germany, so the bank was forced to become beneficial to the nation.

In our life-time how has the Federal Reserve performed ? In the 1990s, when the new economy and the irrational exuberance again reared its head, what did the Fed do ? Nothing. In 2008 the credit-bubble once again went bust. The Fed responded by bailing out the banking industry and rewarding the bankers for their criminal activities ---bankers got the reward, tax-payers got the bill.

In 100 years, the 1914 dollar lost 99% of its purchasing power. In 110 years of most-scientific modern central banking, we had a recession in every decade ---only two of them were as bad as 1929 and 2008, but the bubble did go bust every nine years or so.

Moritz Warburg filled several pages writing about how his scientific-modern central bank will prevent credit-bubbles and the flooding the country with printing-press credit. He spent ten years talking about it to anyone who listened. Yet, when the scientific European rubber hit the fan, it produced the same outcome as every other banking ---because money-corporations can only produce one kind of result.

Moritz Warburg knew all this. He knew the outcome can only be boom-bust ---inflation, loss of purchasing power, more debt, more tax, and even more debt and even more taxes.

The Wall Street Chorus.
1840.

Give us a Bank -- a paper Bank,
The best machine for saving labor,
For who would toil and sweat himself,
When there's a chance to sweat his neighbor.

Away, now, with your power-looms,
Revolving Jacks, and spinning Jennies;
Contrivances for packing wool
Can't match the Banks for picking pennies.

"Ex nihil nihil fit," was once
A maxim much in vogue with some;
But few indeed can now maintain
That "nothing can from nothing come."

For though the ancients could convert
Their gold to rags, (as we are told,)
Yet we, in times more civilized
Can make from rags the best of gold.

All hail, then, glorious alchemy,
That can from nothing something make !
What pity things created thus,
Their primal form are prone to take.

So let us have a Bank, my boys !
A fortune thus we all may win:
Like lilies of the valley live,
Who "toil not, neither do they spin!"

With paper, then, all debts we'll pay,
And should our credit once get low,
It never comes amiss to say,
"The Government has made it so!"

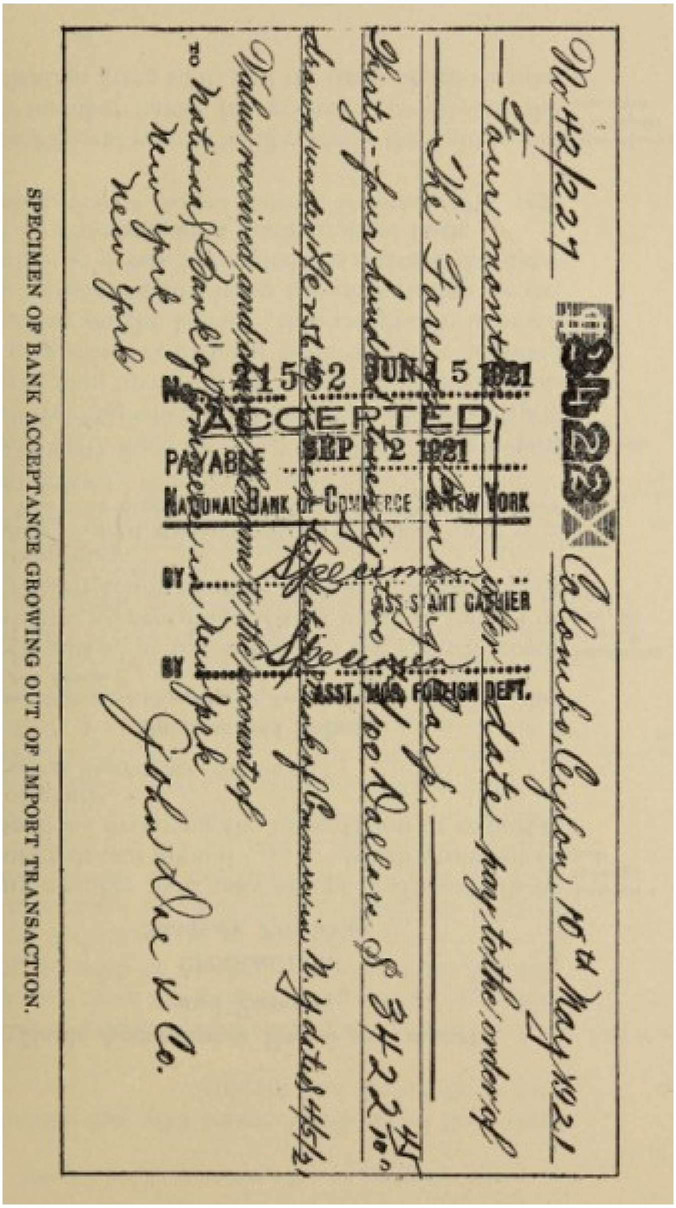
A "bill of exchange" is--- an unconditional order in-writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed, to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person, or to bearer.

A cheque is--- a bill of exchange drawn on a bank, payable on demand.

The term "acceptance" designates a draft or bill of exchange drawn to order, payable at a definite time after date or sight, the obligation to pay which has been accepted by an acknowledgement thereon written or stamped and signed (generally across the face of the instrument) by the party on whom the bill is drawn. This acknowledgment, which generally consists merely of the word "accepted" followed by signature and date, constitutes the agreement of the acceptor to pay the draft at maturity according to its tenor, without qualifying conditions. To be negotiable, such an accepted bill must be for a definite amount and must be payable in money.

An ordinary "trade acceptance" is created when, for example, the seller of merchandise draws a draft for the purchase price on the purchaser and the purchaser accepts the draft. The purchaser, however, may enter into an agreement with his bank whereby the bill is drawn on the bank and is accepted by it for his account instead of by the purchaser himself. Such a draft, when accepted, becomes a "bank acceptance." The Federal Reserve Board has defined a bank acceptance as "a draft or bill of exchange of which the acceptor is a bank or trust company, or a firm, person, company, or corporation engaged generally in the business of granting bankers' acceptance credits."

Bank acceptances are used largely in financing international trade and domestic transactions involving major staple commodities. They hold a pre-eminent place among credit instruments and offer a means of investment in which the credit risk has practically been eliminated. This is due to the fact that direct responsibility for their payment rests on banking institutions whose credit is generally and widely known.



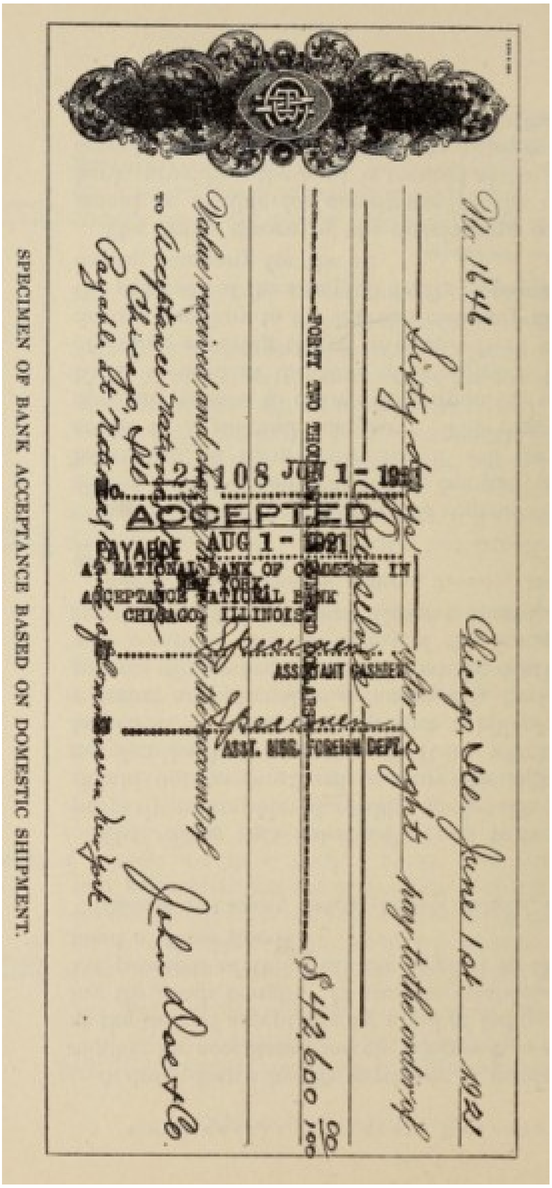
SPECIMEN OF BANK ACCEPTANCE GROWING OUT OF IMPORT TRANSACTION.

the other party doesn't trust me, so I ask my bank to accept responsibility ---for which service I pay my bank a commission

at the other end, the party may not want to wait 60 days for the money, so he asks his bank to discount it for him ---and he instantly receives 94% of the amount as credit to his account

If the two parties were allowed to trust each other, and had other means of transferring money, they could do the transaction without paying 6% to each bank

During the 19th century, there was no acceptance banking in the United States, yet overseas trade functioned and prospered just as well !!!



SPECIMEN OF BANK ACCEPTANCE BASED ON DOMESTIC SHIPMENT.

Frank Arthur Vanderlip (1864-1937), president of National City Bank, bluntly and frankly explained to the Senate Committee, why bankers (like Jacob Schiff) wanted and needed a grand-central discount house, regardless of who owned it:

"In order to have a discount market you have got to make liquid the commodity you sell there; that is, commercial paper. You can only do that by having a central bank, to which the purchaser can go to rediscount. A central bank is necessary for the creation of a discount market, and the discount market is the place where surplus funds will be invested." ---*Arthur Vanderlip, October 8, 1913.*

Jacob Schiff (1847-1920) unleashed acceptance banking in America, and soon no merchant, trader could function without an account with an acceptance bank (and paying 6% for a service he had lived without in his previous life).